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INTERNATIONAL COUNTERTRADE

Draft Legal Guide on International Countertrade Transactions

Report of the Secretary-General

Addendum

CHAPTER SUMMARIES

The Working Group on International Payments decided that, in order to facilitate the use of the Legal Guide, each chapter should be preceded by a summary (A/CN.9/357, para. 15). In accordance with that decision, the present addendum contains summaries of chapters II to XV of the draft Legal Guide.

II. Scope and terminology of Legal Guide

Countertrade transactions covered by the Legal Guide are those transactions in which one party supplies goods, services, technology or other economic value to the second party, and, in return, the first party purchases from the second party an agreed amount of goods, services, technology or other economic value. A distinctive feature of these transactions is the existence of a link between the supply contracts in the two directions in that the conclusion of the supply contract or contracts in one direction is conditioned upon the conclusion of the supply contract or contracts in the other direction (paragraph 1). The discussion in the Guide on goods is generally applicable also to services, and can be used as a broad guidance also for transactions involving technology (paragraph 2). The focus of the Guide is on countertrade transactions in which the goods are delivered across national boundaries (paragraph 3).

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Countertrade transactions take a variety of forms and display differing features. The discussion in the Legal Guide is relevant generally to all types of countertrade unless otherwise indicated (paragraphs 4 to 6).

The Guide focuses on the drawing up of contractual clauses that are specific to or of particular importance for international countertrade (paragraph 7). As a rule, it does not deal with the content of the contracts for individual supplies of goods under a countertrade transaction since those contracts generally resemble contracts concluded as discrete and independent transactions (paragraph 8).

In some countries, countertrade is subject to governmental regulations, which may promote or restrict countertrade in a variety of ways. In addition, various aspects of countertrade transactions are likely to be subject to regulations that are not specifically oriented to countertrade. Since the regulations are disparate and often changed, advice is given, where appropriate, in the form of a general warning that a matter being discussed may be subject to mandatory regulations (paragraphs 9 and 10). Private law questions involved in countertrade generally do not vary from region to region (paragraph 11).

Terminology used in countertrade varies, and no prevailing terminology has developed. The chapter establishes the terminology used in the Legal Guide for various types of countertrade transactions as well as for parties, contracts and subject-matters involved in a transaction (paragraphs 12 to 28).

The terms used for various types of countertrade are: "barter" (paragraph 14); "counter-purchase" (paragraph 15); "buy-back" (paragraph 16); "direct offset" and "indirect offset" (paragraph 17).

The terms used to denote parties to countertrade transactions are: "purchaser"; "supplier" or "party" (paragraph 18); "exporter" or "counter-importer" (paragraph 19); and "importer" or "counter-exporter" (paragraph 20).

The term "countertrade transaction" is used to refer to the whole countertrade arrangement (paragraph 23). The expressions for various contracts forming part of a countertrade transaction are: "countertrade agreement" (an agreement setting forth various stipulations on the manner in which the countertrade transaction is to be implemented (paragraph 24)); "countertrade commitment" (a commitment of the parries to enter into a future contract (paragraph 25)); "supply contracts" (paragraph 26); "export contract", "import contract", "counter-export contract", and "counter-import contract" (paragraph 27).

The use of the term "goods" is explained in paragraph 28.

III. Contracting approach

Parties may embody their obligations in regard to the shipments of goods in the two directions in a single contract or in separate contracts. A single contract may take the form of a barter contract, which is a contract involving an exchange of goods for goods, or the form of a "merged contract", an arrangement in which the two contracts, one for the delivery of goods in one direction and the other for the delivery of goods in the other direction, are merged into one comprehensive contract. The difference between a barter

contract and a merged contract is that, under a barter contract, the delivery of goods in one direction constitutes payment for the delivery of goods in the other direction, while, under a merged contract, each delivery of goods gives rise to a monetary payment obligation (paragraphs 1 to 10).

When the shipments in the two directions are embodied in separate contracts, various contracting approaches are used. Under one approach, the export contract and the countertrade agreement are concluded simultaneously and the counter-export contract is concluded subsequently (paragraphs 11 to 19). This approach is used when the parties wish to finalize a contract for the shipment in one direction (export contract) before they are able to agree on the contract for the shipment in the other direction (counter-export contract). The purpose of the countertrade agreement in such a case is to express the commitment to conclude a counter-export contract or contracts and, to the extent possible, to outline the terms of the future contract and to establish procedures for concluding and carrying out supply contracts. Possible issues to be addressed in such a countertrade agreement are enumerated in paragraphs 29 to 39.

Under another approach, the countertrade agreement is concluded prior to the conclusion of any definite supply contracts. This approach is usually used when the parties wish to lay down a contractual framework within which a certain level of reciprocal trade should be generated over a period of time. The aim of the countertrade agreement in such a case is to express the commitment to conclude supply contracts in the two directions and, to the extent possible, to outline the terms of the future contracts and to establish procedures for concluding and carrying out those contracts (paragraphs 11, 12, 20 and 21). Possible issues to be addressed in such a countertrade agreement are enumerated in paragraphs 29 to 39.

Under yet another approach, the parties conclude simultaneously the separate supply contracts for the shipment in each direction and the countertrade agreement establishing a relationship between those contracts (paragraphs 11, 12, 40 and 41). Since this approach does not require a commitment to conclude future contracts, this contracting approach raises a limited number of issues. The main issue to be addressed in the countertrade agreement is the manner in which the obligations of the parties with respect to the shipments in the two directions are to be linked. Other possible issues are mentioned in paragraphs 41 and 42.

In many countries a party exporting goods, services or technology may obtain insurance against the risk that the payment claim arising from the export will not be paid. Insurable risks include commercial and non-commercial risks. Among the principles on which the export-credit insurance is based, some are particularly relevant to countertrade transactions (paragraphs 43 to 51, in particular 49 to 52).

Parties often require financing in order to be able to carry out the transaction. An important factor in the consideration by the financial institution whether to grant financing is the ability of the party requesting financing to insure its risk that the payment claim arising from its delivery of goods will not be paid. Financing may be in the form of a supplier credit or a buyer credit (paragraphs 53 to 55).

IV. Countertrade commitment

A countertrade commitment is an undertaking to conclude a future contract or a series of supply contracts in one or in both directions (paragraph 1). A commitment may be a "firm" commitment or a more limited "best-efforts" type of commitment. The Legal Guide focuses on firm countertrade commitments (paragraph 2).

The extent of a countertrade commitment, i.e., the amount of goods to be purchased, may be expressed as an absolute monetary value, as a percentage of the value of the goods delivered, or as a number of units of a given type of goods (paragraphs 3 and 4). The countertrade agreement may provide that only the purchases that exceed the usual quantities purchased will be considered as fulfilling the countertrade commitment ("additionality") (paragraphs 5 and 6).

The parties may specify in the countertrade agreement that the period for fulfilment of the countertrade commitment is to commence on a fixed date and to expire on a fixed date (paragraph 7), or that the fulfilment period of an agreed length is to commence when an event specified in the countertrade agreement takes place (paragraph 8). A number of factors are relevant in the determination of the length of the fulfilment period (paragraph 9 to 12). The fulfilment period may be extended in certain circumstances (paragraphs 13 to 16). Where fulfilment of the countertrade commitment involves many shipments over a long period of time, the parties may wish to divide the fulfilment period into subperiods (paragraphs 17 to 20).

The parties should define the supply contracts that will be counted towards fulfilment of the countertrade commitment ("eligible supply contracts"). Eligible supply contracts may be defined by specifying the type of goods to be purchased (paragraphs 21 to 25), by the geographical origin of the goods (paragraphs 26 and 27), by the identity or the type of the supplier (paragraph 28), or by the identity or type of purchaser (paragraph 29). It may be agreed that under certain circumstances non-conforming purchases will be counted towards fulfilment of the countertrade commitment (paragraph 30).

In many countertrade transactions, the full purchase price of a supply contract is deducted from the outstanding countertrade commitment (the deducted amount is referred to as "fulfilment credit"). Sometimes it is agreed that fulfilment credit will be granted at a rate higher or lower than the full purchase price, depending on the type of goods purchased, the identity of the supplier or the time when a purchase is made (paragraphs 31 to 34).

It is advisable that the countertrade agreement indicate the specific action that must be taken in order for the countertrade commitment to be fulfilled. The parties may agree either that fulfilment occurs upon the conclusion of a supply contract or upon the performance of a supply contract (paragraphs 35 to 37).

It is advisable that the parties include in the countertrade agreement, in as definite a manner as feasible, the terms of the future contract (paragraphs 38 to 43) or provide for means for subsequent determination of those terms. Those means include standards or guidelines to be used in determining a particular contract term (paragraphs 44 to 46), determination of a contract term by a third person (paragraphs 47 to 54), and determination of a contract term by a contract party (paragraphs 55 and 56).

In addition, the countertrade agreement may provide for negotiation procedures for the conclusion of a supply contract (paragraphs 57 to 60).

The parties may wish to consider establishing procedures for monitoring and recording the progress made in fulfilment of the countertrade commitment (paragraph 61). Such procedures include the exchange of information (paragraphs 62 to 64), the confirmation of fulfilment of a countertrade commitment (paragraphs 65 to 67), and "evidence accounts" (paragraphs 68 to 74).

V. General remarks on drafting

The parties may find it desirable to establish a checklist of the necessary steps to be taken in negotiating and drawing up contracts constituting the transaction (the countertrade agreement and the supply contracts) (paragraphs 1 and 2). The applicable law may require that the contracts should be in writing; even if no such requirement exists, it is recommended that the contracts be in writing (paragraph 3).

In drawing up contracts that make up the countertrade transaction, the following matters should be taken into account: the relationship between the contract documents, on the one hand, and the oral exchanges, correspondence and draft documents, on the other hand (paragraph 4); designation of one person primarily responsible for supervising the preparation of the drafts (paragraph 5); provisions of the applicable law on the interpretation of contracts and presumptions on the meaning of certain expressions (paragraph 6); mandatory provisions (paragraph 7); introductory recitals (paragraph 8); use of standard forms, general conditions, standard clauses and previously concluded contracts (paragraph 9); use of one or more than one language for the contractual documents (paragraphs 10 to 12); identification and description of the parties in a principal document designed to come first in logical sequence amongst various documents (paragraph 13); the source of the legal status of parties that are legal persons, and any particular considerations when a party is a governmental agency (e.g., authorization for the conclusion of a contract or an arbitration agreement) (paragraph 14); the name, address, status and authority of any agents (paragraph 15).

It is desirable for the parties to consider the form that notifications under the countertrade transaction are to take and the means of transmittal (paragraph 16 and 17), the point of time when notifications are to be deemed effective (paragraph 18), addressees of notifications (paragraph 19), and the consequences of a failure to notify and of a failure to respond to a notification (paragraph 20).

It is advisable to define certain key expressions or concepts that are frequently used in the countertrade agreement or in the supply contracts (paragraphs 21 to 24).

VI. Type , quality and quantity of goods

The discussion concerning "goods" in the Legal Guide is broadly applicable also to services and technology (paragraph 1).

The parties may either identify in the countertrade agreement the type of goods that will be the subject of the future supply contract, possibly

stating only broad categories of goods, or not stipulate the type of goods. Precision as to type, quality and quantity increases the likelihood that the intended supply contract will be concluded. Sometimes, even though the type of countertrade goods is identified in the countertrade agreement, the exact quality and quantity of the goods are left for later determination because the conditions on which the parties wish to base their decision on quantity and quality are not yet fully known (paragraph 2).

Various commercial considerations enter into the selection of the type of goods to be supplied under the countertrade transaction. The freedom of the parties to agree on the type of goods may be affected by government regulations (paragraphs 3 to 6).

When the parties conclude a countertrade agreement without determining the type of goods, they may wish to include in the countertrade agreement a list of goods the purchase of which would count toward fulfilment of the countertrade commitment. If such a list is used, the parties may settle questions such as the availability of goods on the list, purchaser's duty to provide specifications and requirements, "additionality" and procedure for deciding on the type of goods (paragraphs 7 to 14). Services and technology as subject-matters of countertrade are discussed in paragraphs 15 to 23.

The question of quality of countertrade goods raises two main issues that the parties may address in the countertrade agreement: expressing the level of quality that the goods offered for purchase must possess (paragraphs 24 to 28), and the establishment of procedures to ascertain, before the conclusion of a supply contract, whether goods being offered meet the specified level of quality (paragraphs 29 to 32).

The quantity of goods to be purchased may be specified in the countertrade agreement or left to be determined at the time of the conclusion of the supply contracts. The quantity may be expressed as a monetary amount or as a number of units to be purchased, or the quantity may be left to be determined on the basis of the purchaser's requirements or the supplier's output (paragraphs 33 to 39).

Particularly in long-term transactions, it may be provided that, at regular intervals or in response to specified changes of circumstances, the parties will review the provisions in the countertrade agreement on the type, quality or quantity of goods. The parties may wish to stipulate in the countertrade agreement that under certain conditions fulfilment credit would be earned by the purchase of goods other than those stipulated in the countertrade agreement (paragraph 40 and 41).

VII. Pricing of goods

The chapter deals with methods for determining the price of goods that will be the subject-matter of the supply contract to be concluded pursuant to the countertrade commitment. It also deals with certain pricing questions encountered in the specific contexts of supplying services and the transfer of technology. In addition, it discusses the currency in which a price is expressed and the revision of a price.

It is advisable that the parties specify in the countertrade agreement the price of the goods that will be the subject-matter of the future supply contract. When the parties are not able to do so, it is advisable to provide

in the countertrade agreement a method for determining the price at the time the supply contract is to be concluded (paragraphs 1 to 6).

The currency in which the price is to be paid may involve risks arising from the fluctuation in exchange rates between that currency and other currencies. In stipulating the currency, the parties should take into consideration foreign exchange regulations. The parties may wish to denominate the price in a stable currency or in a unit of account (paragraphs 7 to 10).

The countertrade agreement may provide for a determination of the price through the use of a standard, a method that provides a price at the time of the conclusion of a supply contract in a manner not influenced by the will of the parties. Possible price standards include: a reported market price for goods or services of standard quality; production cost of the goods; competitor's price; most-favoured-customer price (paragraphs 11 to 20).

The parties may stipulate in the countertrade agreement that the price to be paid under a future supply contract will be negotiated at a time subsequent to the conclusion of the countertrade agreement. It is advisable that, to the degree possible, the parties agree on guidelines for the negotiation of the price (paragraphs 21 to 24).

Sometimes the parties provide for the price to be set by an independent third person (e.g., a market specialist in the goods in question) (paragraphs 25 and 26). Sometimes it is agreed that the price will be determined by one of the parties to the countertrade agreement, a method with respect to which utmost caution is advisable (paragraph 27).

Prices for services may be set as rates for units of work processes or as a lump sum, or they may be set on a cost-reimbursable basis (paragraphs 28 to 31).

For setting the price for a technology transfer, the two principal forms are the lump-sum payment and payment of royalties (paragraphs 32 to 38).

When multiple shipments are spread out over a period of time, there may be a need to revise the price in order to reflect changes in the underlying economic conditions. A revision may take place at specified points of time or in response to specified changes in the economic conditions (paragraphs 39 to 43). Possible methods of price revision include the reapplication of the method used to determine the original price (paragraph 44); an index clause, a method by which the price of the countertrade goods is made to depend on the levels of the prices of specified goods or services (paragraphs 45 to 47); a currency clause or a unit-of-account clause, whereby the price is linked to an exchange rate between the currency in which the price is to be paid and a stipulated other currency (paragraphs 48 to 52).

VIII. Participation of third parties

The chapter deals with cases in which a party committed to purchase or committed to supply goods, instead of itself purchasing or supplying goods, engages a third party to do so (sections B and C). Section D deals with "multi-party" transactions that are distinct from the cases discussed in sections B and C.

A party committed under a countertrade agreement to purchase goods (party "originally" committed to purchase goods) often engages a third party ("third-party purchaser") to make those purchases (paragraphs 4 to 7). When such participation of a third-party purchaser is envisaged, it is advisable to address in the countertrade agreement the question of the selection of the third-party purchaser and the question of who would be liable to the supplier in the event of a failure by the third party to make the purchases needed to fulfil the countertrade commitment (paragraphs 9 to 20). In addition, the party originally committed to purchase goods and the third-party purchaser should conclude a contract to deal with questions such as the nature of the commitment of the third party (a "firm" commitment or a "best-efforts" commitment, paragraph 22); fee payable to the third party (paragraphs 30 to 36); "hold-harmless" clause (paragraph 37); and the question whether the third party should have an exclusive or non-exclusive mandate to purchase and resell the goods (paragraphs 38 to 40).

Sometimes, the parties to the countertrade agreement agree that the party making purchases beyond what is required to liquidate its outstanding countertrade commitment will be allowed to have the excess fulfilment credit counted towards fulfilment of countertrade commitments that the purchaser or a third party may assume in the future (paragraph 8).

The party committed to supply goods (party "originally" committed to supply) sometimes designates a third party ("third-party supplier") to supply the goods (paragraphs 41 to 44). When the participation of a third-party supplier is envisaged, it is advisable for the countertrade agreement to address the selection of the third party and the consequences of the failure by the third party to make the agreed goods available. In some transactions, the selection of the third-party supplier is left to the party committed to purchase goods (paragraphs 45 and 46). In other transactions, the selection is left to the party originally committed to supply goods (paragraphs 47 to 52).

As to "multi-party" countertrade transactions, three types are described in the chapter: (a) tripartite transaction that involves the exporter (who does not at any stage of the transaction assume a commitment to counter-import), the importer and the third-party counter-importer; (b) tripartite transaction that involves the exporter, the importer (who does not at any stage of the transaction assume a commitment to counter-export) and a third-party counter-exporter; and (c) four-party transaction in which the supply contract in one direction is concluded by one set of parties and the supply contract in the other direction is concluded by two other parties (paragraphs 53 to 58).

IX. Payment

Parties to a countertrade transaction may decide to link payments for the supply contracts in the two directions in such a way that the proceeds generated by the supply contract in one direction are to be used to pay for the supply contract in the other direction. This allows the transfer of funds between the parties to be avoided or reduced (paragraphs 1 to 8).

Sometimes it is agreed that the shipment in a particular direction (export contract) is to precede the shipment in the other direction (counter-export contract) in order to generate funds to pay for the

counter-export. In such a case, sometimes referred to as "advance purchase", it may be agreed that the proceeds of the export contract are to be retained by the importer until payment under the subsequent counter-export contract becomes due (paragraphs 9 to 13). When in an advance-purchase situation the proceeds generated by the export contract are not to be left under the control of the importer, the parties may agree on the use of a "blocked account" or of "crossed letters of credit" (paragraphs 14 to 18). Under a blocked-account method, the proceeds generated by the export contract are deposited in an account at an agreed bank, and the release of the money, intended as payment for the counter-export goods, is subject to agreed conditions (paragraphs 19 to 30). When crossed letters of credit are to be used, the funds payable under a letter of credit opened by the importer in favour of the exporter ("export letter of credit") are blocked in order to be used to cover the letter of credit opened by the counter-importer in favour of the counter-exporter ("counter-export letter of credit") (paragraphs 31 to 37).

The parties may agree that their payment claims arising from the shipments made in the two directions would be set off. If an imbalance arises in the values of the deliveries, it can be settled by delivery of additional goods or by payment of money. In order to facilitate the setoff of claims, in particular in the case of multiple shipments, the parties may wish to use a record-keeping mechanism, which is referred to in the Guide as a "setoff account". A setoff account may be administered by the parties themselves or by a bank or banks (paragraphs 38 to 57).

Certain issues common to linked payment mechanisms (currency, designation of banks, interbank agreements, unused or excess funds, supplementary payments or deliveries, and bank charges) are discussed in paragraphs 58 to 65.

In the case of a "multi-party" countertrade transaction (i.e., "tripartite" or "four-party" countertrade; see chapter VIII), it might be agreed that the proceeds of the supply contract between one pair of parties will be used to pay for the supply contract between a different pair of parties. In a tripartite transaction involving a third-party counter-importer, the importer, instead of transferring money to the exporter under the export contract, delivers goods to the counter-importer and is considered to have discharged the payment obligation for the import up to the value of countertrade goods delivered to the counter-importer; the counter-importer, in turn, pays the exporter an amount equivalent to the value of the goods received from the counter-exporter. Similarly, in a tripartite transaction involving a third-party counter-exporter, the importer transfers funds to the counter-exporter to pay for the shipment to the counter-importer, and the counter-importer (exporter) agrees that the payment claim under the export contract is discharged up to the value of the goods delivered to the counter-importer. In a four-party transaction, the exporter ships goods to the importer, and the importer, instead of paying the exporter, pays to the counter-exporter an amount equivalent to the value of the goods received from the exporter. The payment from the importer to the counter-exporter compensates the counter-exporter for the shipment to the counter-importer. The counter-importer pays to the exporter an amount equivalent to the value of the goods received from the counter-exporter (paragraphs 66 to 73).

As in countertrade involving two parties, blocked accounts and crossed letters of credit may be used in multi-party countertrade (paragraphs 74 to 77).

X. Restrictions on resale of countertrade goods

Sometimes the parties agree in the countertrade agreement or in a supply contract to restrictions on the resale of goods purchased pursuant to the countertrade commitment (paragraphs 1 and 2).

The parties should be aware that many legal systems contain mandatory rules on restrictive business practices, and the parties should ensure that a resale restriction they contemplate using is not in contravention of those rules. Mandatory rules of this type may contain generally worded prohibitions against practices that unduly restrain competition and thereby put competitors or consumers at an unfair disadvantage or harm the national economy. Furthermore, there often exist specific prohibitions against particular types of restrictive business practices (e.g., against agreements setting a minimum price) (paragraph 3).

When a resale restriction is contemplated, it is advisable to be as specific as possible in the countertrade agreement as to the content of the restriction (paragraphs 4 to 7).

Parties to a countertrade transaction sometimes include in the countertrade agreement provisions that restrict the freedom of the supplier of countertrade goods to market the type of goods that are the subject-matter of the countertrade transaction (paragraph 8).

The countertrade agreement may provide that the party purchasing goods under the countertrade agreement is to inform the supplier as to certain aspects of the resale of the goods, such as the territory of resale, resale price, or packaging or marking of the goods (paragraphs 9 and 10).

Parties to a countertrade transaction sometimes agree on restrictions as to the territory where the party purchasing goods may resell those goods (paragraphs 11 to 16).

Sometimes countertrade agreements contain provisions concerning the minimum resale price of the goods. It should be noted that in many States, under mandatory rules relating to restrictive business practices, setting a minimum resale price is generally prohibited or permitted only in limited circumstances (paragraphs 17 to 20).

The countertrade agreement may contain requirements as to the type of packaging or marking to be used in reselling the goods. The parties should ensure that any packaging or marking requirements do not conflict with mandatory provisions at the place where the goods are to be resold (paragraphs 21 and 22).

When it is possible that the party committed to purchase goods will engage a third party to make the purchases, the supplier may be interested in the observation by the third party of resale restrictions stipulated in the countertrade agreement (paragraphs 23 and 24).

Changes in the underlying commercial circumstances may make it appropriate to provide in the countertrade agreement for a review of agreed upon resale restrictions (paragraph 25 and 26).

XI. Liquidated-damages and penalty clauses

Liquidated-damages clauses and penalty clauses provide that a failure by a party to perform a specified obligation, or a failure to perform it on time, entitles the aggrieved party to receive from the party failing to perform a sum of money agreed upon at the time the parties established their contractual relationship. The agreed sum may be intended to stimulate performance of the obligation, or to compensate for losses caused by the failure to perform, or to do both (paragraph 1).

The chapter focuses on liquidated-damages and penalty clauses covering a failure to fulfil the countertrade commitment (paragraph 2). Such a failure may take the form of non-fulfilment or delayed fulfilment of the commitment (paragraphs 3 and 4). The clause may cover the purchaser's commitment to purchase goods or the supplier's commitment to make goods available (paragraphs 5 and 6).

Many national laws have provisions on liquidated-damages and penalty clauses. Those provisions include: a mandatory restriction in some legal systems that clauses fixing an agreed sum to stimulate performance are invalid and that the party subject to such a clause is liable for a failure to perform only for the damages recoverable under the general law (paragraph 7); rules giving a power to the courts to reduce the amount of the agreed sum, or to award additional damages when the actual damage exceeds the agreed sum (paragraph 7); the rule that the agreed sum is not due if the party who failed to perform the obligation in question is not responsible for the failure (paragraph 8); other rules on the relationship between the recovery of the agreed sum and the recovery of damages (paragraph 12).

Liquidated-damages or penalty clauses should be distinguished from clauses limiting the amount recoverable as damages, clauses providing alternative obligations and clauses establishing an obligation to liquidate through cash payments imbalances in the flow of trade in barter contracts or where countervailing payment claims are to be set off (paragraphs 9 and 10).

Where a party originally committed to purchase or to supply goods engages a third party to fulfil that commitment, it may be agreed that the third party is to pay liquidated damages or a penalty to the party originally committed in the event of a breach of the third party's commitment to purchase or to supply goods (paragraph 11).

An important question to consider is whether, by claiming the agreed sum, the beneficiary of the clause should be deemed to have forsaken fulfilment of the underlying obligation. Often the intention of the parties to countertrade transactions is that the beneficiary who chooses to claim the agreed sum is precluded from also claiming the fulfilment of the countertrade commitment. Sometimes, the parties intend that the agreed sum is to be payable for delay in fulfilment of the commitment, in which case the countertrade commitment remains outstanding despite payment of the agreed sum. It is advisable that the parties specify the effect of payment in the countertrade agreement (paragraphs 13 to 16).

The amount of liquidated damages or a penalty may be expressed as an absolute amount or as a percentage of the value of the outstanding countertrade commitment (paragraph 17). When the clause covers delay, an agreed sum is often fixed by way of increments, a specified amount being due for a specified time unit of delay (paragraph 18). Considerations relating to

determining the appropriate amount of the agreed sum are discussed in paragraphs 19 to 23.

Issues related to obtaining the agreed sum that may be dealt with in the countertrade agreement include the following: a cut-off time for claiming the agreed sum (paragraph 24); payment of the agreed sum when the period for the fulfilment of the countertrade commitment is divided into subperiods (paragraph 25); a beneficiary's right to deduct the agreed sum from funds held by the beneficiary or a beneficiary's right to set off the claim to the agreed sum against a countervailing claim (paragraph 26); an independent guarantee to cover the obligation to pay the agreed sum (paragraph 27). The countertrade agreement may also address the possibility to terminate the countertrade commitment when the liquidated-damages or penalty clause covers delay (paragraph 28), and the effect of the termination of the countertrade commitment on the obligation to pay the agreed sum (paragraph 29).

XII. Security for performance

The parties to a countertrade transaction may agree to use a guarantee to cover the fulfilment of the countertrade commitment. A guarantee may be used for the obligation to purchase goods, the obligation to supply goods, or both those obligations (paragraph 1).

A guarantee may be independent of, or accessory to, the underlying obligation. Under an independent guarantee, the guarantor is obligated to pay when the beneficiary of the guarantee presents to the guarantor a demand for payment and any additional document required under the terms of the guarantee; such a document may be, for example, the beneficiary's statement that the party who procured the guarantee (the "principal") has breached the underlying obligation, the beneficiary's statement specifying the circumstances that constitute the breach, or a certificate or decision by a third person stating that the breach of the underlying obligation has occurred. The guarantor, in determining whether to pay, is not called upon to investigate whether the underlying obligation has in fact been breached, but is limited to verifying whether the demand for payment and the supporting documents conform to the requirements specified in the guarantee. Despite the independence of the guarantee from the underlying obligation, payment under the guarantee may exceptionally be refused, in particular when the payment claim is fraudulent (paragraph 3).

Under an accessory guarantee, the guarantor must, before paying a claim, ascertain whether the underlying obligation was breached, and the guarantor is normally entitled to invoke all the defences that the principal could invoke against the beneficiary (paragraph 4).

The discussion in the chapter is limited to independent guarantees, without thereby implying a preference for this type of guarantee. The discussion in the chapter applies not only to securities in the form of guarantees but also to securities in the form of stand-by letters of credit, which are the functional equivalent of independent guarantees (paragraphs 5 and 6).

When a guarantee is to be used, the parties should include in the countertrade agreement provisions on questions such as: who is to procure the guarantee (paragraph 8); whether payment under the guarantee releases the principal from the countertrade commitment (paragraph 9); the identity of the

guarantor or how a guarantor is to be chosen (paragraphs 10 to 16); the documents that the beneficiary would have to present for the guarantor to be obligated to pay (paragraphs 17 to 22); the amount of the guarantee and possibly a mechanism to reduce that amount as fulfilment of the countertrade commitment progresses (paragraphs 23 to 26); time when the guarantee is to be issued (paragraphs 27 to 30); expiry of the guarantee (paragraphs 31 to 33); return of the guarantee instrument (paragraph 34); obligation to procure an extension of the guarantee as a result of an extension of the period for the fulfilment of the countertrade commitment (paragraphs 35 and 36); modification of the underlying commitment and modification of the guarantee (paragraphs 37 to 39).

In transactions in which goods shipped in the two directions are not to be paid in money, guarantees may be used to secure the liquidation through cash payment of a possible imbalance in the flow of trade (paragraphs 40 to 48).

XIII. Failure to complete countertrade transaction

This chapter discusses remedies for non-fulfilment of the countertrade commitment (section B) and circumstances in which a party is exonerated from liability for a failure to fulfil the countertrade commitment (section C). Also discussed is the effect of a failure to conclude or perform a supply contract in one direction on the obligations of the parties to conclude or perform supply contracts in the other direction (section D). The discussion is set in the context of "firm" countertrade commitments (paragraphs 1 to 3).

It is advisable that countertrade agreements stipulate the remedies for a failure to fulfil the countertrade commitment since national laws generally do not contain rules specifically tailored to countertrade (paragraphs 4 and 5). Remedies to be considered are the release of a party from the countertrade commitment (paragraphs 6 to 10) or a monetary compensation, in particular in the form of liquidated damages or a penalty (paragraphs 11 and 12).

During the period for the fulfilment of the countertrade commitment, events of a legal or physical nature may occur that impede, permanently or temporarily, a committed party from concluding an envisaged supply contract. The party who fails to fulfil its commitment due to such an impediment may, according to the applicable law or according to the provisions of the countertrade agreement, be granted additional time to fulfil the commitment or may be released altogether from the commitment. Impediments that give rise to such an exemption are referred to as "exempting impediments" (paragraph 13).

Many national laws contain provisions concerning exempting impediments. However, since those provisions may lead to results that are incompatible with the needs of a given transaction, the parties may wish to include in the countertrade agreement a clause specifying the legal consequences of an exempting impediment (paragraphs 14 to 18) and a clause defining exempting impediments (paragraphs 19 to 34). The countertrade agreement may also contain a requirement that the party invoking an exempting impediment must give written notice of the impediment to the other party (paragraphs 35 and 36).

Since in a countertrade transaction the conclusion of a supply contract in one direction is conditioned upon the conclusion of a supply

contract in the other direction, the question may arise whether a failure to conclude or perform a contract in one direction should have an effect on the obligation to conclude or perform a contract in the other direction. National laws normally do not provide a specific answer to the question of such interdependence of obligations in countertrade transactions. Therefore, in order to avoid uncertainty or disagreement, the parties may wish to include in the countertrade agreement clauses indicating the extent of the interdependence of obligations (paragraphs 37 to 42). Such clauses may address in particular the following problems in the completion of countertrade transactions: failure to conclude a supply contract as stipulated in the countertrade agreement (paragraphs 43 to 48), termination of a supply contract (paragraphs 49 to 55), failure to meet a payment obligation under a supply contract (paragraphs 56 to 60), failure to deliver goods under a supply contract (paragraph 61).

XIV. Choice of law

The chapter focuses on the choice by the parties to a countertrade transaction of the law applicable to the countertrade agreement, the supply contracts in the two directions, and the contract by which a party committed to fulfil a countertrade commitment engages a third party to fulfil that commitment. The chapter considers also the question whether the countertrade agreement and the contracts forming part of the transaction should be made subject to a single national law or to different national laws (paragraph 1).

Under the rules of "private international law" (or "conflict-of-laws" rules) of many States, parties are permitted to choose by agreement the applicable law, though under some of those laws there are restrictions on that choice. If the parties do not choose the applicable law, the applicable law is determined by the application of rules of private international law (paragraph 2). By choosing the applicable law, the parties do not make a choice as to jurisdiction (paragraph 3). Whatever the chosen law, particular aspects of the countertrade transaction may be affected by mandatory rules (paragraphs 4 and 30 to 33). The extent to which the parties may designate issues to be governed by the chosen law may be limited (paragraph 5). The relevance of the United Nations Sales Convention for a countertrade transaction is discussed in paragraph 6.

In order to avoid uncertainty as to what law applies, it is desirable for the parties to choose expressly the applicable law to govern the countertrade agreement and the supply contracts (paragraphs 8 to 11). The extent to which the parties are allowed to choose the applicable law is determined by the rules of private international law. Under some systems of private international law, the autonomy of parties is limited, and they are permitted to choose only a national law that has some connection with the contract (the "nexus" rule). Under most systems of private international law, parties are permitted to choose the applicable law without those restrictions (paragraph 12).

When choosing the applicable law, it is in general advisable to choose the law of a particular country (paragraphs 13 to 18). Parties may wish to take the following factors into consideration in choosing the applicable law: the parties' knowledge of, or possibility of gaining knowledge of, the law; the capability of the law to settle in an appropriate manner the legal issues arising from the contractual relationship; the extent to which the law contains mandatory rules that would prevent the parties from settling by

agreement questions that arise in their contractual relationship (paragraph 19). Further issues the parties may wish to bear in mind are: possible changes legislated in the law chosen by the parties (paragraph 20); approach to the drafting of the choice-of-law clause (paragraph 21); separateness of the choice-of-law clause from the rest of the contract (paragraphs 22); applicability of the chosen law to the prescription of rights (limitations of actions) (paragraph 23); advisability of designating the applicable law not only for the countertrade agreement but also for the future supply contracts (paragraph 24).

In choosing the applicable law, the parties may wish to consider whether the countertrade agreement and the supply contracts should be made subject to a single national law or to different national laws (paragraphs 25 to 29).

XV. Settlement of disputes

It is advisable that the parties agree on the method by which future disputes arising out of the countertrade agreement and the related supply contracts would be settled. Dispute-settlement methods include negotiation, conciliation, arbitration and judicial proceedings (paragraphs 1 to 6). In some States, restrictions exist as to the freedom of a State agency to conclude an arbitration agreement or to agree to the jurisdiction of a court of a foreign State (paragraph 7).

Usually, the most satisfactory method of settling a dispute is through amicable settlement by negotiation between the parties (paragraphs 8 to 11).

If the parties fail to settle a dispute through negotiation, they may wish to attempt to do so through conciliation before resorting to arbitral or judicial proceedings. The object of conciliation is to achieve an amicable settlement of the dispute with the assistance of a neutral conciliator. If the parties provide for conciliation, they may settle relevant procedural issues by agreeing on a set of conciliation rules such as the UNCITRAL Conciliation Rules (paragraphs 12 to 15).

There are various reasons why arbitration is frequently used for settling disputes arising in countertrade transactions (paragraphs 16 and 17). In general, arbitral proceedings may be conducted only if the parties agree thereto. Since it may be more difficult to reach an agreement to arbitrate after a dispute has arisen, it is advisable to enter into an arbitration agreement at the outset of the countertrade transaction (paragraphs 18 and 23). The parties are able to select the type of arbitration that best suits their needs (paragraphs 24 to 26).

The arbitral proceedings will normally be governed by the procedural law of the State where the proceedings take place. It is advisable for the parties to agree on a set of arbitration rules to govern arbitral proceedings under their agreement. When the parties choose to have their arbitrations administered by an institution, the institution may require the parties to use the rules of that institution (paragraphs 27 to 29). Some arbitration rules contain a model arbitration clause that invite the parties to settle in the arbitration clause matters such as the involvement of an appointing authority and the number of arbitrators (paragraphs 30 to 34), the place of arbitration (paragraphs 35 to 39) and the language or languages to be used in the arbitral proceedings (paragraphs 40 and 41).

Disputes that are not settled through negotiation or conciliation can be settled, if the parties do not opt for arbitration, in judicial proceedings. Courts of two or more States may be competent to decide a given dispute. Parties may agree on a jurisdiction clause under which the parties are obligated to submit disputes to a specified court (paragraphs 42 to 45).

Countertrade transactions often involve several contracts, in addition to the countertrade agreement. In such multi-contract transactions, the parties may wish to consider whether it would be desirable to agree on a single body for the settlement of all disputes that may arise in the transaction, i.e., the same conciliator, arbitral tribunal or court (paragraphs 46 to 49).

Disputes may arise in a countertrade transaction that involve or affect not only the exporter and the importer, but other parties as well, in particular third persons engaged in the transaction as purchasers and suppliers of countertrade goods. In such multi-party disputes, it may be desirable to settle all related issues in the same dispute settlement proceedings (paragraphs 50 to 53).